Supreme Court, U. S.
FILED
DEC 11 1980
MICHAEL RODAK, JR., CLERK

No. 80-956

In the Supreme Court of the United States

OCTOBER TERM, 1980

HAROLD H. EMCH, JR. and ELIZABETH R. EMCH, as Co-Personal Representatives of the Estate of Harold H. Emch,

Petitioners,

VS.

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

1. Should the United States Government be liable under the Federal Tort Claims Act to the shareholders of a bank holding company for the Government's negligence at the operational level in the examination and regulation of the bank holding company and its subsidiary banks?*

2. Did the courts below effectively disregard the planning level/operational level distinction in respect to the "discretionary function" exception to Federal Tort Claims Act liability?

3. Are all actions by Government agents in the examination and regulation of banks necessarily "discretionary" within the meaning of the "discretionary function" exception to Federal Tort Claims Act liability?

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* This action was commenced by Harold H. Emch, a major shareholder of American Bankshares Corporation, a bank holding company. During the pendency of the proceedings in the district court, Emch died and the personal representatives of his estate were substituted for him as plaintiffs. In addition to the United States of America, the complaint named as defendants the Comptroller of Currency, the F.D.I.C. and the Federal Reserve Board. The Government moved in the district court to dismiss the Comptrolier, FDIC and FRB as defendants, on the grounds those agencies cannot be sued *eo nomine* under the Federal Tort Claims Act. The plaintiffs did not oppose that motion. The Government also moved to dismiss a cause of action against the FDIC alleged under 12 U.S.C. §1819. Following the Seventh Circuit's decision in *Federal Deposit Insurance Corporation* v. *Citizen's Bank & Trust Company of Parkridge, Illinois* (7th Cir., Feb. 2, 1979) that claim was also dismissed, a ruling not appealed from by the plaintiffs.

4. Are all of the negligent acts alleged by the complaint, if not "discretionary," then within the "misrepresentation," "interference with contract rights," or "fiscal monetary" exceptions to Federal Tort Claim Act liability?

5. Did the courts below err in deciding this Federal Tort Claims Act case on the bare pleadings?

6. Under the applicable law, is it necessary that a negligent defendant owe a duty running to the plaintiff?

7. Should the courts below have allowed plaintiff to file an amended complaint alleging specifically that the Government exceeded its normal regulatory role and assumed substantial control over the day-to-day operations of the American City Bank, during the course of which conduct the Government was negligent?

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NO.

HAROLD H. EMCH, JR. and ELIZABETH R. EMCH, as Co-Personal Representatives of the Estate of Harold H. Emch,

Petitioners,

vs.

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in this case on September 12, 1980.

REFERENCES TO OPINIONS BELOW

The decision of the District Court is reported twice: at 470 F. Supp. 206 and at 474 F. Supp. 99. The latter, which includes both the decision dismissing the complaint and

the decision denying the motion to amend, is the one reprinted at App. 13.

The opinion of the Circuit Court of Appeals is reported at 630 F.2d 523 and is reprinted at App. 1.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on September 12, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTES INVOLVED

28 U.S.C. Sec. 2674:

> The United States shall be liable, respecting the provisions of this title relating to tort claims, in the same manner and to the same extent as a private individual under like circumstances, but shall not be liable for interest prior to judgment or for punitive damages.
>
> If, however, in any case wherein death was caused, the law of the place where the act or omission complained of occurred provides, or has been construed to provide, for damages only punitive in nature, the United States shall be liable for actual or compensatory damages, measured by the pecuniary injuries resulting from such death to the persons respectively, for whose benefit the action was brought, in lieu thereof.

28 U.S.C. Sec. 2680:

> The provisions of this chapter and section 1346(b) of this title [28 USCS § 1346(b)] shall not apply to—
>
> > (a) Any claim based upon an act or omission of an employee of the Government, exercising due care, in the execution of a statute or regulation, whether or not such statute or regulation be valid, or based upon the exercise or performance or the failure to exercise or perform a discretionary

function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused.

* * *

(h) Any claim arising out of . . . misrepresentation . . . or interference with contract rights . . . .

* * *

(i) Any claim for damages caused by the fiscal operations of the Treasury or by the regulation of the monetary system.

* * *

STATEMENT OF THE CASE

This action is brought under the Federal Tort Claims Act, 28 U.S.C. §§1346(b) and 2671-2674. Jurisdiction of the district court was based upon 28 U.S.C. 1346(b). The district court's dismissal was based upon the complaint only; there was no trial or other factual hearing.

The plaintiff Harold H. Emch ("Emch") was the owner of 39,480 shares of stock in American Bankshares Corporation ("American Bankshares"), a Wisconsin-based bank holding company whose largest subsidiary was a national bank, the American City Bank & Trust Company ("American City Bank"). American City Bank was declared insolvent by the Comptroller of Currency October 21, 1975, and Emch's stock in American Bankshares thereby became worthless.

The complaint (App. 24) charges the United States of America (the "Government"), through personnel from the office of the Comptroller of Currency, the Federal Deposit Insurance Corporation and the Federal Reserve Board, was negligent at the operational level of activity in the regulation and examination of American City Bank and American Bankshares in that it:

a. Failed to exercise reasonable care at the operational level of their activities in the regulation of the American City Bank and American Bankshares.

b. Failed to exercise due care at the operational level in the regulation, investigation, testing and analysis of the financial condition and operations of the American City Bank and American Bankshares.

c. Permitted fraudulent and misleading reports to be issued to the shareholders of American Bankshares.

d. Permitted and acquiesced in numerous fraudulent activities by the American City Bank and American Bankshares, and their officers, accountants and others associated or dealing with them.

e. Made numerous mistakes, errors and omissions in the course of examining the American City Bank and American Bankshares.

Each of these negligent acts and omissions is alleged to be a proximate cause of the insolvency of American City Bank and the destruction in value of Emch's American Bankshares stock.

The district court granted the Government's motion to dismiss the complaint, holding the wrongs alleged against the Government came within the "discretionary function" and "misrepresentation" exceptions to Federal Tort Claim liability. Emch then moved for modification of the dismissal order, requesting that he be allowed to amend his complaint to include a specific allegation that the Government exceeded its normal regulatory role and assumed substantial control over the day-to-day operations of the American City Bank. This motion was denied. Emch then appealed to the Court of Appeals for the Seventh Circuit, which affirmed the district court.

ARGUMENT

INTRODUCTION:

This petition raises a question of broad national importance, not yet decided by this Court: Whether the Government should be liable under the Federal Tort Claims Act for operational-level negligence in the course of its examination and regulation of banks and bank holding companies.

Petitioners do *not* challenge the Government's immunity from Federal Tort Claims liability for negligence at the policy or planning level. To the contrary, petitioners limit their claim to operational-level negligence, as to which, they contend, the Government should be liable like any private individual or firm would be.

Nonliability means irresponsibility. In the private sector, manufacturers know failure to make a product safe means liability for damages; doctors and lawyers know failure to perform with due care also means liability. An accounting firm knows that a negligent audit of a bank resulting in the bank's demise will mean liability. That should be just as true where the auditors' paychecks come from the Government as where they come from one of the Big Eight accounting firms. Human nature is the same for businessmen, professionals and Government bureaucrats. Knowledge that they will be held liable for failure to use due care makes them more careful.

I.

THE FEDERAL TORT CLAIMS ACT SHOULD BE CONSTRUED LIBERALLY IN FAVOR OF LIABILITY.

In the face of constitutional guarantees against uncompensated harm by the Government (including, among

others, the due process clause) and a common law system usually requiring that the wrongdoer rather than the victime bear the burden of a loss, the Government for years enjoyed a common law privilege accorded the English King: immunity from liability for torts.

In 28 U.S.C. §2674, Congress sought to correct that anomaly by providing that:

> The United States shall be liable, respecting the provisions of this title relating to tort claims, in the same manner and to the same extent as a private individual under like circumstances, ...

Certain exceptions to this liability (i.e., preservations of immunity) were also provided for, however, in 28 U.S.C. §2680:

> (a) Any claim . . . based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or any employee of the Government, whether or not the discretion involved be abused.
>
> * * *
>
> (h) Any claim arising out of . . . misrepresentation . . . or interference with contract rights . . . .
>
> * * *
>
> (i) Any claim for damages caused by the fiscal operations of the Treasury or by the regulation of the monetary system.
>
> * * *

The Government asserted below that each of the above exceptions applied to this case, and further, that Emch was not entitled to recover in any event because the Government owed no duty to him as a shareholder. The district court granted the motion to dismiss, based principally upon the "discretionary function" exception [28 U.S.C. §2680(a)].

Governmental immunity is a doctrine which is generally repudiated or interpreted as restrictively as possible by most state jurisdictions. See *Muskopf* v. *Corning Hosp. Dist.*, 55 Cal.2d 211, 359 P.2d 457, 458-9, 11 Cal. Rep. 89 (1961). A vestige of the 15th-18th century common law theory that the King can do no wrong, the doctrine is inimical to the United States Constitution and to the very reason the defendant Government was established in the first place. Accordingly, the Federal Tort Claims Act should be liberally construed in favor of liability and against the exceptions preserving immunity. *United States* v. *Yellow Cab Co.*, 340 U.S. 543, 547, 548 (note 5), 71 S. Ct. 399, 95 L. Ed. 523 (1951); *United States* v. *Aetna Cas. & Surety Co.*, 338 U.S. 366, 380 (1949). (5th Cir.) (1956).

II.

THE DECISIONS OF THE COURTS BELOW WERE IN CONFLICT WITH DECISIONS IN OTHER CIRCUITS IN DISMISSING THIS CLAIM ON THE BARE PLEADINGS.

Pursuant to the federal court practice of notice pleading, Emch filed a complaint in general terms alleging negligence of various government agencies at the operational level in their regulation and examination of American City Bank. Central to what we submit was an erroneous disposition by the courts below, was their willingness to dismiss this case on the bare pleadings.

The principal battleground of this case is whether the Government can successfully bring each of the negligence acts and omissions of each of its agents within the "discretionary function" exception to Federal Tort Claims Act liability. As discussed in the next section of this brief, that depends upon whether the specific acts and omissions to be proved by Emch at a trial were at the "planning"

or at the "operational" level of activity. See *American Exch. Bank of Madison, Wis.* v. *United States,* 257 F.2d 938, 941 (1958). That determination cannot be made without knowing factually what specific activities are involved. For this reason most federal courts hold that the determination of whether a Federal Tort Claims Act exception applies should not be made on bare pleadings. *Smith* v. *United States,* 113 F.Supp. 131, 116 F.Supp. 801 (D.C. Del. 1953); *Guy F. Atkinson Co.* v. *Merritt Chapman & Scott Corp.,* 126 F.Supp. 406 (D.C. Cal. 1954); *California* v. *United States,* 151 F.Supp. 570 (D.C. Cal. 1957); cf. *Hamman* v. *United States* 267 F.Supp. 411 (D.C. Mont. 1967). Here, what the courts below have effectively held is that no actions of government examiners and regulators can ever be at the operational level—they are always at the planning ("discretionary") level. No authority exists for that holding, and it violates common sense.

It should also be noted that both of the courts below erred in suggesting plaintiffs have waived any claim arising ". . . out of the ordinary, although negligent, performance by federal agencies of their regulatory banking functions." (App. 4, 7, 17-18). We attach at App. 49 an excerpt from plaintiffs' brief filed in the court of appeals, giving citations to the district court record and constituting our argument in the court of appeals showing we did not waive to such claims. Plaintiffs' allegations include the kind of negligence in extraordinary activities referred to in *In re Franklin National Bank Securities Litigation,* 445 F.Supp. 723, 728-734 (E.D.N.Y. 1978), but are not limited to such negligence.

To the contrary, the gravamen of the plaintiffs' allegations deals precisely with the ordinary, though negligent, performance of bank examination and regulation activities by federal agents. Plaintiffs contend that such activities occur across a spectrum ranging from broad policy

decisions (where immunity is preserved under the discretionary function exception to FTCA liability) to auditing errors and similar mistakes involving no policy or planning considerations (where immunity is not preserved). The *Franklin National Bank* species of negligence may be at the extreme end of that spectrum, but liability should not be limited to that extreme case. Plaintiffs respectfully submit that, in view of the policy considerations discussed earlier in this petition, liability should be the rule whenever, in the spectrum of examining or regulatory activities, discretion no longer plays any significant role.

III.

THE "DISCRETIONARY FUNCTION" EXCEPTION DOES NOT APPLY.

The complaint expressly alleges that governmental agents were negligent at the *operational* level of their activities in examining, investigating and regulating American City Bank and American Bankshares (App. 26-29). Where negligence is at the operational level rather than at the planning or policy level, the "discretionary function" exception does not apply. *American Exch. Bank of Madison, Wis.* v. *United States,* (*supra,* at 941); Reynolds, *The Discretionary Function Exception of the Federal Tort Claims Act,* 57 Georgetown L.J. 81 (1968); *State of California* v. *United States,* Supra, at 572; see also Court of Appeals' decision at App. 7.

A principal case on which the Government relied below was the California district court decision in *Harmsen et al.* v. *Smith et al.,* reprinted at App. 34. This case, however, expressly recognized the operational/planning level distinction referred to above, stating that a cause of action against the Comptroller for negligent performance of the examination of a bank and for negligently failing to super-

vise or control its agents in the conduct of those examinations does *not* come within the discretionary function" exception to liability.* The court stated (App. 44):

> The provisions of the Tort Claims Act preclude liability for "(a)ny claim based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency." 28 U.S.C. §2680(a). In discussing this exception, the courts have distinguished between decisions made at the "planning" level and those at the "operational" level. *United Air Lines, Inc.* v. *Wiener*, 335 F.2d 379, 392 (9th Cir.), cert. dismissed, 379 U.S. 951 (1964). This distinction means, in essence, that the government is immune from liability in determining what policy should be—e.g., in the establishment of regulations and procedures—but that once the government has adopted a particular procedure, it may be held liable for failing properly to satisfy its requirements. *Griffin* v. *United States*, 500 F.2d 1059, 1069 (3d Cir. 1974).

The court further pointed out (App. 44-45) that a suit for damages challenging the procedures set forth in the *Comptroller's Handbook of Examination Procedures* might be barred by the "discretionary function" exception, but that "... that exception does not apply to suits alleging failure properly to execute the examination in a manner set forth in the *Handbook*." Accordingly, the court said the exception did not apply to negligent failure to supervise and control agents in the conduct of those examinations. This very kind of negligence, of course, is included within the allegations of the instant complaint.

---

* The Court in *Harmsen et al.* v. *Smith et al.* dismissed the action on another ground not applicable to the instant case—namely, that under California indemnity law there must be a duty running from the tortfeasor to the plaintiff. This was affirmed in *Harmsen et al.* v. *Smith et al.*, 586 F.2d 156 (9th Cir. 1978).

It was plain error for the courts below broadly to hold, as they in effect did, that all acts of all government agents in all examinations and other regulatory activities relating to banks are all "discretionary."

IV.

THE "MISREPRESENTATION" EXCEPTION DOES NOT APPLY.

The "misrepresentation" exception was another issue argued by the Government below. The case relied upon by the Government, *Harmsen et al.* v. *Smith et al.*, supra, was in fact decided adversely to the Government's position taken here. The court therein held (App. 46):

> Exclusion (h) 28 U.S.C. §2860(h) bars "(a)ny claim arising out of . . . misrepresentation." If the bank directors otherwise were entitled to indemnity, this provision would not apply to this case for the reasons applicable in *United Air Lines, Inc.* v. *Wiener,* 335 F.2d 379 (9th Cir.), cert. dismissed, 379 U.S. 951 (1964):
>
> The government's reliance upon 18 U.S.C. §2860(h) relating to exemption from the Tort Claims Act of causes of action predicated upon misrepresentation is misplaced. This action applies to claims arising out of misrepresentation. *United States* v. *Neustadt,* 366 U.S. 696 (1960). Here the gravament of the action is not misrepresentation but the negligent performance of operational tasks, although such negligence consisted partly of a failure of a duty to warn. *Id.* at 398.

It is plain the gravamen of the instant action as a whole is negligent performance of operational tasks. To the extent some of the negligence involved permitting fraudulent reports to be issued by the bank to shareholders, the misrepresentation involved is by the *bank,* not the Government. The Government's liability arises from its negligence in permitting that activity to occur.

V.

THE "INTERFERENCE WITH CONTRACT RIGHTS" AND "FISCAL-MONETARY" EXCEPTIONS DO NOT APPLY.

In its argument below the Government also asserted two other exceptions (28 U.S.C., 2680(h) and (i)): the "interference with contract rights" and the "fiscal-monetary" exceptions. Neither applies. The Government never identified what *contract* it was referring to, except for a suggestion that a certificate of stock is merely a contract. That is plain error. It is self-evident a shareholder is an owner of a corporation, not a contracting party with a corporation.

Similarly, there is no authority whatever for the assertion of the "monetary-fiscal system" exception. The only case cited below by the Government which deals directly with the question decides adversely to the Government. *Harmsen et al.* v. *Smith et al.*, supra, holds (App. 46-47):

> Section 2680(i) creates an exception for "(a)ny claim for damages caused by the fiscal operations of the Treasury or regulation of the monetary system." The parties have not cited any reported cases construing this provision. The government argues, however, that the monetary system in this country essentially is the banking system, and that "money" is defined by economists with reference to the banking system since it is characterized as currency in circulation plus demand deposits.
>
> The definition proposed by the goverment is overly broad. Monetary policy has been defined as those "activities of the federal government intended to produce changes in the money supply, the availability of loanable funds, or the level of interest rates to influence general economic activity." Based upon this definition of "regulation of the monetary system," not

all supervision of banking fits within this provision. *The particular conduct at issue in this case—i..e, the carrying out of bank examinations required by §481—does not fall within the scope of the §2680(i) exception.* (Emphasis added)

VI.

THE COMPLAINT STATES A CAUSE OF ACTION.

The Government also argued below that its agents owed no duty of due care running to the plaintiff, a shareholder, so that the complaint failed to state a cause of action on behalf of Emch. The district court did not reach this issue because of its holding that any alleged negligence came within the "discretionary function" exception to Federal Tort Claim Act liability (App. 16).

Typical of the authorities relied upon by the Government is *Harmsen et al.* v. *Smith et al.,* supra, which held there was no liability under California indemnity law since the examining agencies of the Government owed no duty of due care running to the shareholders of the bank. That impact of California law was the basis for the 9th Circuit's affirmance of the dismissal in *Harmsen* v. *Smith,* 586 P.2d 156 (1978). See also *Social Security Administration Baltimore Federal Credit Union* v. *United States,* 138 F. Supp. 639 (D. Md. 1956).

The error in the Government's position is that Wisconsin law, which controls, does *not* require that the duty run to the injured party or claimant.

It is well settled that the determination of whether a claim has been stated in a Federal Tort Claims action is governed by the law of the state in which the tortious conduct occurred. See Anno: Tort Claims Act—Effect of State Law 1 L. Ed. 2d 1647, 1648; 7 L. Ed. 2d 994, 995; *Fleishour* v. *United States,* 365 F.2d 125, 148 (7th Cir.

1966), *cert. den.* 385 U.S. 987; *Schmidt* v. *United States.* 369 F. Supp. 64, 66 (D.C. Wis. 1974).

Wisconsin law has long been settled that liability does not depend upon establishing that the tortfeasor had a duty running to the claimant. The development of this law was described in *Schilling* v. *Stockel,* 26 Wis. 2d 625, 631 (1965) as follows:

> Commencing in 1952, with *Pfeifer* v. *Standard Gateway Theater, Inc.* (1952), 262 Wis. 229 5 N.W. (2d) 29, we ruled on a number of cases in which we rejected "the no-duty formula of Palsfraf and Waube," to use the phraseology of *Longberg* v. *H.L. Green Co.* (1962), 15 Wis. (2d) 505, 516, 113 N.W.(2d) 129, 114 N.W. (2d) 435. See *Colla* v. *Mandella* (1957), 1 Wis. (2d) 594, 598, 85 N.W. (2d) 345, and *Klassa* v. *Milwaukee Gas Light Co.* (1956), 273 Wis. 176, 77 N.W. (2d) 397. Duty is still an important factor in determining whether an act is negligent. E.g., *Szep* v. *Robinson* (1963), 20 Wis. (2d) 284, 121 N.W. (2d) 753. However, once an act has been found to be negligent, we no longer look to see if there was a duty to the one who was in fact injured.

This same language was quoted by the Wisconsin Supreme Court in *A.E. Investment Corp.* v. *Link Builders, Inc.* 62 Wis.2d 479, 483-84 (1974) which emphasized the fact that the duty (the obligation to use due care) *need not run to the claimant* (62 Wis.2d 484).

A further in depth analysis of Wisconsin negligence law was set forth in *Coffey* v. *Milwaukee,* 74 Wis.2d 526 (1976), which is particularly applicable here. *Coffey* held that even where a city building inspector's negligence consisted of failure to use due care in the exercise of a so-called "public duty"—which is what the Government has contended for in the instant case—such negligence is actionable where it in fact causes damage to another.

In *Coffey* v. *Milwaukee* the City of Milwaukee and its building inspector contended that the duties imposed on the building inspector regarding fire safety inspections were clearly duties owed to the public in general and not to the specific plaintiff. On the basis of *A.E. Investment Corp.* v. *Link Builders, Inc.* (Supra), and other numerous Wisconsin cases, the court rejected this contention and expressly rejected the line of authorities which would require first the duty to run directly to the claimant in order for there to be liability. 74 Wis.2d 526, 536. The authorities expressly rejected by the Wisconsin court took the identical position argued by the Government here.

Under Wisconsin tort law, therefore, a defendant's duty "... is established when it can be said that it was foreseeable that his act or omission to act may cause harm to someone." *A.E. Investment* v. *Link Builders, Inc.*, (Supra), page 484; *Coffey* v. *Milwaukee,* (Supra), page 536. In the instant case, the Government does not and in good faith could not contest the foreseeability of harm to Emch and the other shareholders of American Bankshares from its failure to use due care in its examination and regulation of American Bankshares and its subsidiary, American City Bank.

VII.

THE COURTS BELOW SHOULD HAVE PERMITTED AMENDMENT OF THE COMPLAINT.

After the district court entered its initial decision dismissing the complaint, Emch moved for leave to amend his complaint so that he at least could proceed to prove up his case based upon negligence such as charged in *In re Franklin National Bank Securities Litigation,* 445 F. Supp. 723, 728, 731, 733-34 (E.D.N.Y. 1978).

The original complaint, we submit, permitted litigation of those issues; however, the trial court in its decision (App. 18) found that it did not.

Having so found, the court should have permitted amendment of the complaint to permit litigation of such negligence. The reason given by the district court was that the administrative notice given by Emch did not cover such a negligence claim. (App. 20-21).

To begin with, paragraph "d" does cover such a claim (See Court of Appeals decision at App. 2). Secondly, it is obvious filing another notice of such a claim would be a fruitless act. One of the agencies with which Emch's original claim was filed did not even bother to respond (the Federal Reserve Board) and those that did respond denied the claim. Third, from the original filing of that claim in April, 1977, the Government has had ample notice that a claim was being made and by whom, which would suffice for any agency having a sincere interest in administrative negotiation and disposition of a claim. Finally, the administrative claim requirement must be read in light of the remedial purposes of the Federal Tort Claims Act, which was passed to remove the legal anomaly of governmental immunity. (See Sec. I of this brief above.)

CONCLUSION

We therefore ask that a writ of certiorari issue so that the judgments of the courts below can be reversed and this case can be remanded for trial.

Respectfully submitted,

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APPENDIX

APPENDIX A

In the

United States Court of Appeals

For the Seventh Circuit

Before SWYGERT, *Circuit Judge*, WOOD, *Circuit Judge*, and NOLAND, *District Judge*.*

NOLAND, *District Judge*. This is an appeal by Harold H. Emch, Jr. and Elizabeth R. Emch as corepresentatives of the estate of Harold H. Emch. Appellants challenge the district court's dismissal of their complaint against the United States for falure to state a claim upon which relief can be granted and its subsequent refusal to permit the filing of an amended complaint. For the reasons set forth below, we affirm the district court's actions in all respects.

The facts may be briefly summarized as follows. On October 21, 1975, the American City Bank & Trust Company (American City Bank) was declared insolvent by the Comptroller of the Currency and was taken over by the Federal Deposit Insurance Corporation (FDIC), acting as receiver. This action allegedly rendered worthless some 39,480 shares of stock held by Emch, Sr., in American Bankshares Corporation, a bank holding company holding 100% of the outstanding shares of American City Bank, its largest subsidiary. Emch thereafter filed administrative claims with the Comptroller, the FDIC,

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* District Judge James E. Noland of the Southern District of Indiana is sitting by designation.

and the Federal Reserve Board pursuant to 28 U.S.C. § 2675,[1] which were subsequently denied. The substance of the claims, in pertinent part, was as follows:

> d. Said undersigned claim they have been damaged as the result of your failure for the years 1971, 1972, 1973, 1974, and 1975 inclusive, to properly and adequately supervise, examine and control the condition, performance, operation, liquidity and solvency of American City Bank and Trust Company N.A., a banking entity of Milwaukee, Wisconsin, and in failing to take proper and adequate measures to correct deficiencies, including but not limited to violation of lending and collateral rules existing in said bank and in said holding company and in failing to take proper and adequate measures to preserve and conserve the assets of said bank and said holding company.
>
> e. As the result of paragraph (d) above, the said holding company, to-wit: American Bankshares Corporation became insolvent and its stock (including the stock of the undersigned) became worthless.

Following the denial of his claims at the administrative level Emch, on April 18, 1977, instituted the action underlying this appeal. The complaint, filed under the provisions of the Federal Tort Claims Act, 28 U.S.C.

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[1] The Federal Tort Claims Act, 28 U.S.C. § 2675(a), provides:
An action shall not be instituted upon a claim against the United States for money damages for injury or loss of property or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, unless the claimant shall have first presented the claim to the appropriate federal agency and his claim shall have first been finally denied by the agency in writing and sent by certified or registerd mail.

§§ 1346(b) and 2671-74, charged that the United States, by way of the Comptroller's Office, the FDIC, and the Federal Reserve Board, was negligent at the "operational level" in the regulation and examination of American City Bank and American Bankshares Corporation, and that such negligence proximately caused the insolvency of American City Bank and the resultant investment losses suffered by Emch. Upon motion by the Government, the district court dismissed the Comptroller, the FDIC, and the Federal Reserve Board as defendants, as well as a separate claim against the FDIC alleged under 12 U.S.C. § 1819. These actions are not challenged in this appeal. Subsequently, however, the district court ruled that the alleged wrongs on the part of the United States fell within the "discretionary function" or "misrepresentation" exceptions to Federal Tort Claim liability.[2] In its order reported at 470 F.Supp. 206 and again at 474 F.Supp. 99 (E.D. Wis. 1979), the court dismissed Emch's claim, saying:

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[2] Sections 2680(a) and (h) of the Federal Tort Claims Act, 28 U.S.C. § 2680(a) and (h), make the provisions of the Act inapplicable to:

> (a) Any claim based upon an act or omission of an employee of the Government, exercising due care, in the execution of a statute or regulation, whether or not such statute or regulation be valid, or based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused.
>
> . . . .
>
> (h) Any claim arising out of assault, battery, false imprisonment, false arrest, malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit, or interference with contract rights. . . . .

> The government argues, and numerous cases have held, that § 2680(a) precludes suits based on negligence by agencies of the United States in the regulation and examination of banks . . . and that § 2680(h) precludes suit against the United States for withholding relevant information from the public or for permitting a bank to publish misleading or fraudulent reports . . . . Indeed, at the oral argument held on March 9, 1979, it appeared to the Court that plaintiff is not arguing that tort claims against the United States can arise out of the ordinary, although negligent, performance by federal agencies of their regulatory banking functions.

474 F.Supp. at 101 (citations omitted). The district court rejected Emch's contention that the federal agencies acted beyond the scope of their normal regulatory holes and "undertook to perform extraordinary and extrastatutory functions, i.e., the day-to-day management of the affairs of the bank," and were therefore not entitled to the protections afforded by the discretionary function or misrepresentation exceptions to tort liability contained in Sections 2680(a) and (h). *Id.* Referring to the decision in *In re Franklin National Bank Securities Legislation,* 445 F.Supp. 723 (E.D.N.Y. 1978), in which claims of operational level negligence by federal agencies were held sufficient to withstand a dismissal motion based upon the provisions of Section 2680(a), the district court held that, despite Emch's use of the word "operational" in his complaint, the cause of action alleged was not of the type set forth in *In re Franklin National Bank Securities Litigation,* and was accordingly barred by the provisions of 28 U.S.C. §§ 2680(a) and (h). 474 F.Supp. at 102.

Plaintiff Emch thereafter moved to amend the order of dismissal and for leave to file an amended complaint so as to more fully assert that the examining agencies had taken over, and were negligent in, the day-to-day management and operation of American City Bank. The district court denied the motion, noting that in his administrative claims, a prerequisite to suit under the Federal Tort Claims Act, Emch nowhere alleged such extrastatutory or "operational level" negligence. 474 F. Supp. at 103. This appeal followed.

The issues presented for review are (1) whether the district court erred in dismissing Emch's complaint for failure to state a claime cognizable under the Federal Tort Claims Act, and (2) whether the district court erred in refusing to modify the dismissal order and to allow Emch to amend his complaint so as to specifically allege extrastatutory or operational level negligence. As previously indicated, we have concluded that the court below acted correctly in all respects, and therefore affirm the decision of which the appellants complain. The following discussion will outline the reasons for our conclusion.

The adoption of the Federal Tort Claims Act, 28 U.S.C. §§ 1346(b), 2671-80, marked a major step away from the long tradition, rooted in common law, of sovereign immunity. The Act permits the maintenance of private actions for money damages against the United States "under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred."[5] However, the amenability of the government

[5] 28 U.S.C. § 1346(b).

to private suits under the Act is not without restriction. As noted in the oft-cited decision in *Dalehite v. United States,* 346 U.S. 15, 73 S.Ct. 956 (1953), the Act's legislative history indicates that it was not contemplated that the government should be subject to liability for errors in administration or in the exercise of discretionary functions. *Id.* at 26-27, 73 S.Ct. at 963. This sentiment is embodied in section 2680(a), the discretionary function exception, which formed the basis for the Court's holding in *Dalehite* that the Government could not be held liable for damage arising out of the explosion of shipboard fertilizer grade ammonium nitrate under government supervision.

Considerable conflict has revolved around the concept of "discretionary functions or duties" in the context of tort claim immunity. Although the Court in *Dalehite* declined to define the boundaries of the phrase, it did note that

> [it] includes more than the initiation of programs and activities. It also includes determinations made by executives or administrators in establishing plans, specifications or schedules of operations. Where there is room for policy judgment and decision there is discretion. It necessarily follows that acts of subordinates in carrying out the operations of government in accordance with official directions cannot be actionable.
>
> . . . .
>
> In short, the alleged "negligence" does not subject the Government to liability. The decisions held culpable were all responsibly made at a planning rather than operational level and involved considerations more or less important to the practicability of the Government's fertilizer program.

Id. at 35-42, 73 S.Ct. at 968-71 (footnotes omitted). This policy or planning, as opposed to operational, level distinction has served as the primary test for applicability of section 2680(a) since *Dalehite.* Although other courts have entertained suggestions of distinctions based upon governmental, as opposed to non-governmental, activities, *Indian Towing Company v. United States,* 350 U.S. 61, 76 S.Ct. 122 (1955) (rejecting the proffered distinction), or upon behavior involving rule application as opposed to that of rulemaking, *Hendry v. United States,* 418 F.2d 747 (2d Cir. 1969), the existence of a discretionary function, and thus the potential for governmental liability under the Federal Tort Claims Act, ultimately rests upon the characterization of the challenged behavior as "policy" or "operations." In making this determination, relevant considerations include whether or not the nature of the judgment exercised called for policy considerations. *Griffin v. United States,* 500 F.2d 1059 (3rd Cir. 1974), and whether the Act complained of is "the result of a judgment or decision which it is necessary that the Government official be free to make without fear or threat of vexatious or fictitiuos suits and alleged personal liability," *Ove Gustavsson Contracting Co. v. Floete,* 299 F.2d 655, 659 (2d Cir. 1962).

Appellants do not argue that federal agencies charged with regulation of banking institutions are liable for losses arising out of the normal, although negligent, performance of statutory regulatory functions.[4] Instead, they

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[4] Indeed, the case forming the cornerstone of appellants' arguments herein suggests that mere negligent performance of statutory regulatory activities cannot subject the government to liability. See *In re Franklin National Bank Securities Litigation,* 445 F.Supp. 723, 729-31 (E.D. N.Y. 1971). *See also Ove Gustavsson Contracting*

(footnote continued)

contend that the complaint dismissed below adequately and effectively alleged operational level negligence on the part of the federal agencies and that it therefore stated a viable claim under the planning/operational level test so as to avoid the exception provided by section 2680 (a). Specifically, appellants point to the decision in *In re Franklin National Bank Securities Litigation*, 445 F. Supp. 723 (E.D. N.Y. 1978) as the basis for their allegations of error at the district court level. In that case, the Court held that section 2680(a) did not bar negligence claims against the United States where the third party complaints clearly asserted that the federal agencies had taken over actual operation of a bank previously declared insolvent. The Court stated:

> [W]hile the chartering of a national bank by the United States is a discretionary decision exempt from scrutiny, as is the fixing of the date of declaration of insolvency, however, once having taken control of a bank, as it is alleged to have done here, it could not operate it in a negligent manner without being subject to liability.

45 F. Supp. at 735 (citation omitted)

(footnote continued)

Co. v. *Floete*, 299 F.2d 655 (2d Cir. 1962), and *Zabala Clemente* v. *United States*, 567 F.2d 1140, 1151 (1st Cir. 1977), in which the court stated:

> We do not believe that the expanded role of the federal government in the safety area through such legislation as OSHA indicates an intent of Congress to make the United States a joint insurer of all activity subject to inspection. . . . Nor do we believe that there is any sound policy basis for requiring that government attempts to protect the public must be accompanied by per se tort liability if they are unsuccessfully carried out.

The district court in the case at bar did not take issue with the holding *in re Franklin National Bank Securities Litigation.* It simply held that the allegations of negligence in the instant case were not of the type held to be sufficient in *Franklin National,* stating:

> Despite plaintiff's inclusion of the word "operational" in his complaint, the Court is persuaded that a fair reading of the complaint filed in this cause fails to disclose a cause of action of the type discussed in *In re Franklin National Bank Securities Litigation, supra,* and that the claim as actually set forth is barred by the provisions of 28 U.S.C. §§ 2680(a) and (h).

474 F. Supp at 102.

Keeping in mind that, as the district court correctly noted, a court considering a motion to dismiss should look at the substance of a claim alleged and not merely at the language used in stating it, *Gaudet* v. *United States,* 517 F.2d 1034 (5th Cir. 1975), it is clear that the claims in this case are quite unlike those considered in *Franklin National.* The assertion that the various regulatory agencies "[f]ailed to exercise reasonable care at the operational level of their activities in the regulation of the American City Bank and American Bankshares Corporation," and "[f]ailed to exercise due care at the operational level in the regulation, investigation, testing and analysis of the financial condition and operation of the American City Bank and American Bankshares Corporation," cannot reasonably be interpreted as stating claims for negligence in the day-to-day operation and management of a bank or bank holding company. Rather, the essence of the claims is the allegation of negligent per-

formance of regulatory and statutory supervision or monitoring of the bank entities. As such, they cannot be sustained in light of the provisions of section 2680(a).

The remainder of the allegations set forth by the appellants were also found by the district court to have been barred by the exceptions contained in 28 U.S.C. § 2680. They basically assert that the federal agencies were negligent in permitting the issuance of fraudulent and misleading reports to American Bankshares' stockholders, in permitting fraudulent activities by officers and business associates of American City Bank and American Bankshares, and in committing numerous "mistakes, errors, and omissions in the course of examining" the bank and its holding company. These, too, fall facially within the exception provided by section 2680(a), and were properly dismissed by the district court.

What remains to be considered is whether the district court erred in refusing to permit amendment of Emch's complaint so as to allege extrastatutory or operational level negligence. Central to our determination that the district court did not err in denying the request for leave to amend is the fact that in Emch's initial claims against various federal agencies at the administrative level, absolutely no allegation of "operational level" negligence was made. As previously noted, the claims asserted that shareholders of American Bankshares Corporation had suffered losses as a result of the failure of the various federal agencies to

> properly and adequately supervise, examine and control the condition, performance, operation, liquidity and solvency of American City Bank and Trust Company . . . and in failing to take proper and adequate measures to correct deficiencies, including but not

> limited to violation of lending and collateral rules existing in said bank and in said holding company and in failing to take proper and adequate measures to preserve and conserve the assets of said bank and said holding company.

From this language it is clear that the administrative level claims were an attempt to saddle the government with liability on the basis of its failure, in the course of its statutory regulatory activities, to anticipate the financial difficulties of American City Bank, to insure the honesty and competency of its officers, and to successfully prevent the losses to American Bankshares' stockholders which resulted from the bank's various difficulties. These are claims of the type which section 2680(a) was designed to preclude, and largely for this reason they were deemed inadequate by the administrative agencies against which they were made. No allegation of extrastatutory or operational level negligence was made which could serve to bypass the discretionary function exception.

It is well settled that a court acting on a motion for leave to amend a complaint in circumstances similar to those presented by the facts of this case is vested with considerable discretion, and that its determination may not be reversed absent a showing that such discretion has been abused. *Stanek* v. *Trailmobile, Inc.*, 283 F.2d 827, 828 (7th Cir. 1960). In view of the absence at the administrative level of allegations of operational level negligence, and inasmuch as the filing of a claim with the appropriate administrative agency is a jurisdictional prerequisite to suit under the Federal Tort Claims Act, 28 U.S.C. § 2675(a); *Best Bearings Co.* v. *United States*, 463 F.2d 1177, 1179 (7th Cir. 1972), we hold that the dis-

trict court properly denied the motion for leave to amend so as to permit the appropriate agencies the first opportunity to review any claims of extrastatutory or operational level negligence. Accordingly, the decision of the district court in this and all other respects is hereby AFFIRMED.

A true Copy:

Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B

Harold H. EMCH, Plaintiff,

v.

The UNITED STATES of America, et al., Defendants.

Civ. A. No. 77-C-677.
United States District Court, E. D. Wisconsin.

May 7, 1979.
On Motion to Amend Order for Dismissal Aug. 15. 1979.

Suit was brought against the United States and various federal defendants to obtain damages for the decline in value of certain stock held by plaintiff. Plaintiff alleged that negligence on the part of United States and its agents was a proximate cause of the insolvency of a certain bank and of the loss in value of plaintiff's stock in the bank's parent corporation. On defendant's motion to dismiss, the District Court, Reynolds, Chief Judge, held that: (1) the Federal Deposit Insurance Corporation was not a proper party defendant in a suit under the Federal Tort Claims Act, and (2) the claim as set forth was barred by the sections of the FTCA which provide that the United States is not liable on any claim based on the exercise or performance of a discretionary function or duty or on any claim arising out of misrepresentation.

DECISION AND ORDER

REYNOLDS, Chief Judge.

This is an action for damages arising out of the decline in value of stock held by the plaintiff Harold H. Emch in American Bankshares Corporation following the insolvency of its subsidiary, the American City Bank & Trust Company. Jurisdiction is alleged pursuant to the Federal Tort Claims Act, 28 U.S.C. §§ 1346(b) and 2671-2680, and, with respect to the fourth cause of action which is against the Federal Deposit Insurance Corporation ("F.D.I.C."), pursuant to 12 U.S.C. § 1819. The defendants are the United States of America, the Comptroller of the Currency, the F.D.I.C., and the Board of Governors of the Federal Reserve System. The matter is presenty before the Court on the defendants' motion to dismiss the complaint. For the following reasons, the motion will be granted.

In his brief filed September 8, 1978, in opposition to the Government's motion to dismiss, the plaintiff concedes at pages 1-2 that in a suit brought pursuant to the Federal Tort Claims Act, the only proper party defendant is the United States, and with respect to the other three defendants he agrees to dismissal of all except the fourth cause of action, which is brought against the F.D.I.C. under 12 U.S.C. § 1819.

The fourth cause of action will also be dismissed. There is no dispute that it is a claim founded in tort. In *Federal Deposit Insurance Corporation* v. *Citizens Bank & Trust Company of Park Ridge, Illinois*, 592 F.2d 364 (7th Cir. 1979), the court stated at 371:

> "* * * we hold that the waiver of immunity from tort liability of a federal agency or governmental corporation such as FDIC is defined in the Federal Tort Claims Act, and that sue-and-be-sued authority [such as that set forth in 12 U.S.C. § 1819] does not permit suit outside that Act for torts excepted from the coverage of the Act. In so holding we align this circuit with the decisions of all the courts in other circuits that have addressed the question."

The plaintiff in his first, second and third causes of action alleges that the defendant United States, its officers, agents, agencies, and employees were negligent in that they:

"(a) Failed to exercise reasonable care at the operational level of their activities in the regulation of the American City Bank and American Bankshares Corporation.

"(b) Failed to exercise due care at the operational level in the regulation, investigation, testing and analysis of the financial condition and operations of the American City Bank and American Bankchares Corporation.

"(c) Permitted fraudulent and misleading reports to be issued to the shareholders of American Bankshares Corporation.

"(d) Permitted and acquiesced in numerous fradulent activities by the American City Bank and American Bankshares Corporation, and their officers, accountants and others associated or dealing with them.

"(e) Made numerous mistakes, errors and omissions in the course of examining the American City Bank and American Bankshares Corporation."

(Complaint, paragraphs 7, 11, and 15.)

The plaintiff further alleges that the negligence described was a proximate cause of the insolvency of the American City Bank and the loss in value of plaintiff's stock in American Bankshares Corporation.

Section 2674 of Title 28 U.S.C. provides that the United States shall be liable in tort under the same circumstances and in the same manner as a private individual.* Section 2680 of Title 28 U.S.C., however, provides that the United States shall not be liable on certain claims, including:

> "(a) Any claim * * * based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused.
>
> "* * *
>
> "(h) Any claim arising out of * * * misrepresentation * * *."

The Government argues, and numerous cases have held, that § 2680(a) precludes suits based on negligence by agencies of the United States in the regulation and examination of banks, see, e. g., *Huntington Towers, Ltd.* v. *Franklin National Bank,* No. 75-C-972 (E.D.N.Y. July 1, 1976) (Appendix F to Government's brief filed January 16, 1978), aff'd in part and rev'd in part, 559 F.2d 863 (2d Cir. 1977); *Federal Deposit Insurance Corporation* v. *M/V Concho,* Civil No. 75-1098-E (S.D.Cal. April 15, 1977) (Appendix D to Government's brief filed January 16, 1978);

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* For purposes of this decision only, and because it need not reach the issue in order to decide the pending motion to dismiss, the Court assumes the existence of a duty under Wisconsin law under the circumstances of this case which could form the basis for suit against a private individual. But *cf. In re Franklin National Bank Securities Litigation,* 445 F.Supp. 723, 729-731 (E.D.N.Y. 1978).

Davis v. *Federal Deposit Insurance Corporation,* 369 F. Supp. 277 (D.Colo. 1974), and that §2680(h) precludes suit against the United States for withholding relevant information from the public or permitting a bank to publish misleading or fradulent reports. See, e. g., *Federal Deposit Insurance Corporation* v. *M/V Concho,* supra; *Huntington Towers, Ltd.* v. *Franklin National Bank,* supra; *Federal Deposit Insurance Corporation* v. *Friedman, Heffner, Kahan & Dysart,* Civil No. 76-510-N (S.D.Cal. April 13, 1977) (Appendix E to Government's brief filed January 16, 1978); *Safeway Portland Employees' Federal Credit Union* v. *C. H. Wagner & Co., Inc.,* 501 F.2d 1120 (9th Cir. 1974); *United States* v. *Neustadt,* 366 U.S. 696, 81 S.Ct. 1294, 6 L.Ed.2d 614 (1961). Indeed, at the oral argument held on March 9, 1979, it appeared to the Court that plaintiff is not arguing that tort claims against the United States can arise out of the ordinary, although negligent, performance by federal agencies of their regulatory banking functions.

Instead, it appeared during the oral argument that plaintiff is arguing that liability should be imposed because the federal agencies in the case of the American City Bank & Trust Company during the final months prior to its dissolution undertook to perform extraordinary and extrastatutory functions, i. e., the day-to-day management of the affairs of the bank. In *In re Franklin National Bank Securities Litigation,* 445 F.Supp. 723, 728, 731, 733-734 (E.D.N.Y. 1978), the court did hold that when a federal agency exceeds its "normal regulatory role" and assumes "substantial control over the day-to-day operations" of the bank, thereby inducing the bank and bank directors to rely on the agency's actions to prevent fraud, the United States loses its Federal Tort Claims Act protection from liability and subjects itself to suit if it has negligently

performed the extrastatutory functions which it has undertaken to perform.

In this case, however, the complaint does not allege operational level negligence of the type found by the court to have been alleged in *In re Franklin National Bank Securities Litigation,* supra. Indeed, in that case the court noted that "the allegations [of the complaint] here makes [sic] this an extraordinary case." 445 F.Supp. at 734. The court also held that negligent performance by federal agencies of their *statutory* duties to regulate and examine banks will not subject the United States to suit under the Federal Tort Claims Act. 445 F.Supp. at 729-731. A court should look at the substance of the claim alleged and not merely at the language used in stating it. *Gaudet* v. *United States,* 517 F.2d 1034 (5th Cir. 1975); *Fitch* v. *United States,* 513 F.2d 1013 (6th Cir. 1975); *Lambertson* v. *United States,* 528 F.2d 441 (2d Cir. 1976). Despite plaintiff's inclusion of the word "operational" in his complaint, the Court is persuaded that a fair reading of the complaint filed in this case fails to disclose a cause of action of the type discussed in *In re Franklin National Bank Securities Litigation,* supra, and that the claim as actually set forth is barred by the provisions of 28 U.S.C. § 2680(a) and (h).

IT IS THEREFORE ORDERED that the motion of the defendants the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System to dismiss the complaint against them is granted, and the complaint is dismissed as to them with prejudice.

IT IS FURTHER ORDERED that the motion of the defendant United States of America to dismiss the complaint against it is granted, and the complaint is dismissed as to it without prejudice.

ON MOTION TO AMEND ORDER OF DISMISSAL

The above-entitled action is before the court on plaintiff's motion to amend the order of dismissal and the judgment entered on May 7 and 8, 1979, and for leave to file an amended complaint against the United States. The motion will be denied. The defendant has objected to the motion on the ground that plaintiff has failed to exhaust his administrative remedies, which are a prerequisite to suit under the Federal Tort Claims Act ("FTCA"), see 28 U.S.C. § 2675(a), with respect to his claim as set forth in the proposed amended complaint.

On May 7, 1979, the court dismissed the complaint on the basis that it alleged acts by the defendants which were discretionary in nature and that the defendants were therefore immune from suit under the discretionary function exception of the FTCA set forth in 28 U.S.C. §§ 2674 and 2680(a). The court also stated that operational level negligence by the defendants in the performance of extra-statutory duties would subject the United States to suit under the Federal Tort Claims Act:

> "* * * In *In re Franklin National Bank Securities Litigation*, 445 F.Supp. 723, 728, 731, 733-34 (E.D. N.Y. 1978), the court did hold that when a federal agency exceeds its 'normal regulatory role' and assumes 'substantial control over the day-to-day operations' of the bank, thereby inducing the bank and bank directors to rely on the agency's actions to prevent fraud, the United States loses its Federal Tort Claims Act protection from liability and subjects itself to suit if it has negligently performed the extra-statutory functions which it has undertaken to perform." (Decision and order issued May 7, 1979, at page 4.)

It is this type of claim which the plaintiff wishes to assert in his amended complaint.

The filing of a claim with the appropriate administrative agency or agencies is a jurisdictional prerequisite to suit under the FTCA.** 28 U.S.C. § 2675(a); *Best Bearings Co.* v. *United States,* 463 F.2d 1177, 1179 (7th Cir. 1972); *House* v. *Mine Safety Appliances Company,* 573 F.2d 609, 614 (9th Cir. 1978); *Lunsford* v. *United States,* 570 F.2d 221 (8th Cir. 1977). The purpose of the requirement is to permit administrative consideration of and settlement of claims and to avoid unnecessary litigation. 1966 U.S. Code Cong. & Admin. News, at pp. 2515-2527; *Commonwealth of Pennsylvania* v. *National Association of Flood Insurers,* 520 F.2d 11, 23 n. 27 (3d Cir. 1975); *Executive Jet Aviation, Inc.* v. *United States,* 507 F.2d 508, 517 (6th Cir. 1974). In order to permit adequate admintstrative consideration, the claimant may be required by the agency to submit sufficient information to allw it to make an informed evaluation of the claim. *Kornbluth* v. *Savannah,* 398 F.Supp. 1266 (E.D.N.Y. 1975); *Rothman* v. *United States,* 424 F.Supp. 13 (C.D.Cal. 1977); 28 C.F.R. § 14.4(c)(5).

On April 4, 1979, the plaintiff filed an administrative claim with the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Board of Governors of the Federal Reserve System. (Affidavit of Gerard Smolin, Jr., filed June 5, 1979, paragraph 5, and exhibit A to the affidavit.) The substance of the claim is as follows:

> "d. Said undersigned claim they have been damaged as the result of your failure for the years 1971, 1972, 1973, 1974, and 1975 inclusive, to properly and adequately supervise, examine and control the condition, performance, operation, liquidity and solvency

** The Court expresses no opinion as to whether the statute can be tolled under certain circumstances, see, e. g., *Executive Jet Aviation, Inc.* v. *United States,* 507 F.2d 508, 517 (6th Cir. 1974), if, for example, plaintiff in this case should have difficulties with the statute of limitations.

> of American City Bank and Trust Company N.A., a banking entity of Milwaukee, Wisconsin, and in failing to take proper and adequate measures to correct deficiencies, including but not limited to violation of lending and collateral rules existing in said bank and in said holding company and in failing to take proper and adequate measures to preserve and conserve the assets of said bank and said holding company."

The plaintiff nowhere alleged that the defendants had actually taken over the management or operation of the American City Bank and Trust Company. Thus his claim was denied by the Comptroller based in part specifically on the discretionary function exception to the FTCA, 28 U.S.C. § 2680(a). (See exhibit C to Smolin affidavit.)

The Court noted in its May 7, 1979 decision and order at page 4 that a valid claim of the type which plaintiff now seeks to present would be " 'an extraordinary case.' " While it seems unlikely that any of the appropriate federal agencies, having denied plaintiff's prior claim, would now grant this "extraordinary" claim, nevertheless 28 U.S.C. § 2675(a) requires that they be allowed the first opportunity to review the claim. *Napier* v. *United States*, No. C-77-35-G (M.D.N.C. January 3, 1979) (exhibit D to supplemental memorandum of the United States filed June 5, 1979). Also since the administrative review procedure is designed in part to ease the workload of the courts, it should be of some assistance that the parties will be required to review the information on which the claim is based and the merits of the claim prior to litigating it.

IT IS THEREFORE ORDERED that the motion of the plaintiff Harold H. Emch to amend the order of dismissal and the judgment entered on May 7 and 8, 1979, and for leave to file an amended complaint against the United States is denied.

APPENDIX C

OPINION BY JUDGE NOLAND

JUDGMENT — ORAL ARGUMENT

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604
September 12, 1980
Before
Hon. Luther M. Swygert, Circuit Judge
Hon. Harlington Wood, Jr., Circuit Judge
Hon. James E. Noland, District Judge*

HAROLD H. EMCH, JR., and ELIZABETH R. EMCH, as Co-Personal Representatives of the Estate of Harold H. Emch,

Plaintiffs-Appellants,

No. 79-2243

THE UNITED STATES OF AMERICA, et al.,

Defendants-Appellees.

Appeal from the United States District Court for the Eastern District of Wisconsin
No. 77-C-677
John W. Reynolds, Chief Judge

This cause was heard on the record from the United States District Court for the Eastern District of Wisconsin, Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this Court filed this date.

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* District Judge James E. Noland of the Southern District of Indiana is sitting by designation.

APPENDIX D

UNITED STATES DISTRICT COURT
For The
Eastern District of Wisconsin
Civil Action File No. 77-C-677

HAROLD H. EMCH,

Plaintiff,

vs.

UNITED STATES OF AMERICA, et al,

Defendant.

JUDGMENT

This action came on for consideration before the Court, Honorable, John W. Reynolds, United States District Judge, presiding, and the issues having been duly considered and a decision having been duly rendered, granting defendants' motions to dismiss,

It is Ordered and Adjudged that the action is dismissed with prejudice against the defendants Federal Deposit Insurance Corporation, the Comptroller of the Currency and the Board of Governors of the Federal Reserve System and dismissed without prejudice against the defendant United States of America.

Ruth W. La Fave
Clerk of Court
by: *Betty A. Michaelson*

APPENDIX E

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

HAROLD H. EMCH,

Plaintiff.

vs.

THE UNITED STATES OF AMERICA, THE COMPTROLLER OF CURRENCY, THE FEDERAL DEPOSIT INSURANCE CORPORATION and THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,

Defendants.

Civil Action No. ———

COMPLAINT AND DEMAND FOR JURY TRIAL

The plaintiff complains against the defendants as follows:

I.

GENERAL ALLEGATIONS

1. The plaintiff Harold H. Emch (hereinafter referred to as "Emch") resides at 7307 North Bridge Lane, Milwaukee, Wisconsin 53217, and is a citizen of the State of Wisconsin. The defendant United States of America ("United States") is the Government of the United States of America. The defendant Comptroller of Currency ("Comptroller") is the chief officer of the Bureau of the Comptroller of the Currency in the Depatment of the

Treasury of the United States of America charged with the supervision of the national banking system pursuant to the National Bank Act, 12 U.S.C. Sec. 1, et seq. The defendant Federal Deposit Insurance Corporation ("F.D.I.C.") is a corporation established by Congress pursuant to the Federal Deposit Insurance Act, 12 U.S.C. 1811 et seq. and is a banking agency of the Government of the United States of America. The defendant Board of Governors of the Federal Reserve System ("Federal Reserve Board") is an agency of the Government of the United States of America established by Congress by the Federal Reserve Act, 12 U.S.C. Sec. 221 et seq.

2. In 1971 Emch acquired 39,480 shares of stock in American Bankshares Corporation, a Wisconsin corporation engaged in business as a bank holding company. Its largest subsidiary was the American City Bank & Trust Co. ("American City Bank") which at that time was a bank chartered by the State of Wisconsin. In about December 1972 the American City Bank obtained a national charter and thereafter until October 21, 1975 it operated as a national banking association. At all relevant times its principal offices were located in Milwaukee, Wisconsin. Emch has continuously owned his stock in American Bankshares Corporation from 1971 to the present time.

3. On October 21, 1975, the American City Bank was declared insolvent by the Comptroller, and the F.D.I.C. was named as receiver for American City Bank. By virtue of the insolvency of American City Bank the stock held by Emch in American Bankshares Corporation became worthless.

4. Pursuant to 28 U.S.C. Sec. 2675, the plaintiff on April 6, 1977 presented by certified mail his claims hereinafter set forth to the appropriate Federal agencies, namely, the Comptroller, the F.D.I.C. and the Federal Reserve

Board. On April 30, 1977 the F.D.I.C. finally denied these claims in writing by a letter sent by certified mail. On October 7, 1977 the Comptroller finally denied these claims in writing by a letter sent by certified mail. The Federal Reserve Board has wholly failed to respond to and to make a final disposition of plaintiff's said claims.

II.

As a first cause of action against the United States and the Comptroller Emch alleges:

5. Incorporate all of the allegations of paragraphs 1 through 4 above as though fully set forth herein.

6. Jurisdiction for this cause of action is conferred upon the court by the Federal Tort Claims Act, 28 U.S.C. Secs. 1346(b) and 2671-2674.

7. For some time prior to October 21, 1975 the United States and the Comptroller, who were charged with the responsibility of regulating the American City Bank and American Bankshares Corporation, were negligent in that they and each of them, and their officers, agents, agencies and employees:

(a) Failed to exercise reasonable care at the operational level of their activities in the regulation of the American City Bank and American Bankshares Corporation.

(b) Failed to exercise due care at the operational level in the regulation, investigation, testing and analysis of the financial condition and operations of the American City Bank and American Bankshares Corporation.

(c) Permitted fraudulent and misleading reports to be issued to the shareholders of American Bankshares Corporation.

(d) Permitted and acquiesced in numerous fraudulent activities by the American City Bank and American Bankshares Corporation, and their officers, accountants and others associated or dealing with them.

(e) Made numerous mistakes, errors and omissions in the course of examining the American City Bank and American Bankshares Corporation.

8. Each of the negligent acts and omissions of the United States and of the Comptroller was a proximate cause of the insolvency of the American City Bank and of the destruction in value of the stock held by Emch in American Bankshares Corporation, all to the damage of Emch in the amount of $1,342,320.

III.

As a second cause of action against the United States and the F.D.I.C. Emch alleges:

9. Incorporate by reference all of the allegations of paragraphs 1 through 4 above as though fully set forth herein.

10. Jurisdiction for this cause of action is conferred upon the court by the Federal Tort Claims Act, 28 U.S.C. Secs. 1346(b) and 2671-2674.

11. For some time prior to October 21, 1975, the United States and the F.D.I.C., who were charged with the responsibility of regulating the American City Bank and American Bankshares Corporation, were negligent in that they and each of them, and their officers, agents, agencies and employees:

(a) Failed to exercise reasonable care at the operational level of their activities in the regulation of the American City Bank and American Bankshares Corporation.

(b) Failed to exercise due care at the operational level in the regulation, investigation, testing and analysis of the financial condition and operations of the American City Bank and American Bankshares Corporation.

(c) Permitted fraudulent and misleading reports to be issued to the shareholders of American Bankshares Corporation.

(d) Permitted and acquiesced in numerous fraudulent activities by the American City Bank and American Bankshares Corporation, and their officers, accountants and others associated or dealing with them.

(e) Made numerous mistakes, errors and omissions in the course of examining the American City Bank and American Bankshares Corporation.

12. Each of the negligent acts and omissions of the United States and of the F.D.I.C. was a proximate cause of the insolvency of the American City Bank and of the destruction in value of the stock held by Emch in American Bankshares Corporation, all to the damage of Emch in the amount of $1,342,320.

IV.

As a third cause of action against the United States and the Federal Reserve Board Emch alleges:

13. Incorporate by reference all of the allegations of paragraphs 1 through 4 above as though fully set forth herein.

14. Jurisdiction for this cause of action is conferred upon the court by the Federal Tort Claims Act, 28 U.S.C. Secs. 1346(b) and 2671-2674.

15. For some time prior to October 21, 1975, the United States and the Federal Reserve Board, who were charged with the responsibility of regulating the American City Bank and American Bankshares Corporation, were negligent in that they and each of them, and their officers, agents. agencies and employees:

(a) Failed to exercise reasonable care at the operational level of their activities in the regulation of the American City Bank and American Bankshares Corporation.

(b) Failed to exercise due care at the operational level in the regulation, investigation, testing and analysis of the financial condition and operations of the American City Bank and American Bankshares Corporation.

(c) Permitted fraudulent and misleading reports to be issued to the shareholders of American Bankshares Corporation.

(d) Permitted and acquiesced in numerous fraudulent activities by the American City Bank and American Bankshares Corporation, and their officers, accountants and others associated or dealing with them.

(e) Made numerous mistakes, errors and omissions in the course of examining the American City Bank and American Bankshares Corporation.

16. Each of the negligent acts and omissions of the United States and of the Federal Reserve Board was a proximate cause of the insolvency of the American City Bank and of the destruction in value of the stock held by Emch in American Bankshares Corporation, all to the damage of Emch in the amount of $1,342,320.

V.

As a fourth cause of action against the F.D.I.C. Emch alleges:

17. Incorporate by reference all of the allegations of paragraphs 1 through 4 above as though fully set forth herein.

18. Jurisdiction for this cause of action is conferred upon the court by 12 U.S.C. Sec. 1819.

19. For a substantial period of time prior to October 21, 1975, the F.D.I.C. had notice of numerous fraudulent, illegal, improper and negligent activities by the American City Bank, American Bankshares Corporation, their officers, accountants and others associated or dealing with them, and also had notice of the financial condition and the operations of the American City Bank and of the lack of adequate measures being taken to stop the said fraudulent activities, to correct the procedures and generally to avoid the clear threat of insolvency to the American City Bank. The F.D.I.C. further knew or in the exercise of ordinary care should have known that failure on its part to act would result in the insolvency of the American City Bank.

20. Notwithstanding the notice and the knowledge referred to in paragraph 19 above, the F.D.I.C. failed to take proper and timely action to investigate, regulate and control the activities of the American City Bank. By virtue of said failure the F.D.I.C. abused its discretion in respect to the regulatory powers and duties conferred upon it and was negligent. Said negligence was a proximate cause of the insolvency of the American City Bank, as a result of which the stock held by Emch in American Bankshares Corporation became worthless, all to Emch's damage in the amount of $1,342,320.

WHEREFORE, the plaintiff demands judgment against the defendants and each of them in the amount of $1,342,320, plus interest, costs and disbursements herein.

GEORGE P. KERSTEN
KENAN J. KERSTEN
EDWARD S. GRODIN
JAMES S. GRODIN
Attorneys for Plaintiff

By *George P. Kersten*
George P. Kersten

OF COUNSEL:
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231 W. Wisconsin Avenue
Milwaukee, WI 53203
(414) 271-0054

DEMAND FOR JURY TRIAL

Plaintiff demands a jury trial as to each and every cause of action set forth in the above complaint.

GEORGE P. KERSTEN
KENAN J. KERSTEN
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JAMES S. GRODIN
Attorneys for Plaintiff

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APPENDIX F

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

HAROLD H. EMCH,

Plaintiff,

vs.

THE UNITED STATES OF AMERICA, THE COMPTROLLER OF CURRENCY, THE FEDERAL DEPOSIT INSURANCE CORPORATION and THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,

Defendants.

C.A. No. 77-C-677

MOTION TO AMEND ORDER AND JUDGMENT

Pursuant to rules 59 and 60, Federal Rules of Civil Procedure, the plaintiff moves the court to amend the order entered herein May 7, 1979 and the judgment entered herein May 8, 1979 to provide that:

(a) The defendants' motion to dismiss is granted as to the defendants Federal Deposit Insurance Corporation, the Comptroller of Currency and the Board of Governors of the Federal Reserve System, but denied as to the defendant United States of America.

(b) The action is dismissed with prejudice as to the defendants Federal Deposit Insurance Corporation, the Comptroller of Currency and the Board of Governors of the Federal Reserve System.

(c) The plaintiff shall file an amended complaint against the defendant United States of America within twenty days after entry of the order amending the order and judgment referred to above.

The grounds for this motion are the decision and order of the court entered herein May 7, 1979, and the other grounds as more particularly set forth in the attached memorandum.

Dated this 17th day of May, 1979.

/s/ *George P. Kersten*
George P. Kersten
Attorney for the Plaintiff

APPENDIX G

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

Civil Nos. 73-460-E — 74-345-E

FRED H. HARMSEN, et al.,

Plaintiffs,

v.

C. ARNHOLT SMITH, et al.,

Defendants.

FEDERAL DEPOSIT INSURANCE CORPORATION as Receiver of United States National Bank,

Plaintiff in Intervention,

v.

C. ARNHOLT SMITH, et al.,

Defendants.

ERNEST W. HAHN,

Third-Party Plaintiff,

v.

UNITED STATES OF AMERICA,

Third-Party Defendant.

MEMORANDUM OF DECISION AND ORDER

This motion raises the issue of the right of a director of a national bank to seek indemnity from the United

States for negligent acts of its agent, the Comptroller of the Currency, in conducting examinations of the bank. This court would hold that there is no such right to indemnity, on the grounds that the Comptroller has no duty toward the bank of its shareholders so as to give rise to a cause of action for negligence, and that, even if there were such a duty, any breach of duty would not be of such a character as to give rise to a right of indemnity. Accordingly, the motion of the United States to dismiss the Third-Party Complaint for Indemnity, brought by Ernest W. Hahn, should be granted.

Hahn was a director of the United States National Bank ("USNB") from 1965 until July 28, 1972, approximately fifteen months before the bank was declared insolvent by the Comptroller of the Currency. Hahn has been named as a defendant in the two underlying complaints filed in this action against former directors of USNB and other persons and corporation: the Second Amended Consolidated Complaint filed on behalf of holders of shares of USNB common stock on the date that the bank closed ("class plaintiffs"); and the complaint in intervention filed by the Federal Deposit Insurance Corporation ("FDIC") as receiver of the bank. The complaints allege violations of various statutory and common law duties in connection with the failure of the bank.

Hahn has filed a Third-Party Complaint against the United States, seeking indemnity for the "full amount of any judgment that Hahn might be obligated to pay to plaintiffs or to plaintiff in intervention in this action." The action is brought pursuant to the Federal Tort Claim Act, 28 U.S.C. §§ 2674 *et seq.*, and alleges three causes of action. First, it is contended that the Comptroller neg-

ligently performed the examinations of the bank, which are required by 12 U.S.C. § 481,[1] and that as a result, Hahn was not informed of the true financial condition of USNB or of any violations of the banking laws. Second, Hahn alleges that the Comptroller negligently failed to supervise or control its agents in the conduct of those examinations. Third, the complaint states that the Comptroller was negligent in failing to discover the violations and in failing to report them to the Board of Governors of the Federal Reserve Bank, so that the Board could remove the officers and directors of the bank from office, as authorized by 12 U.S.C. § 1818(a).

The third-party defendant has brought a motion to dismiss based upon two grounds: (1) that Hahn is not entitled to seek indemnity from the United States under California law and (2) that even if there were such a right to indemnity, it would be barred by sovereign immunity, since the claims are covered by various exceptions to the Federal Tort Claims Act. Although in agreement with much of the Third-Party Plaintiff's position on this second issue, the court would hold that there is no right of indemnity which could support this action.

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[1] Section 481 provides, in part:

> The Comptroller of the Currency, with the approval of the Treasury, shall appoint examiners who shall examine every national bank twice in each calendar year. . . . The examiner making the examination of any national bank shall have power to make a thorough examination of all the affairs of the bank and in doing so he shall have power to administer oaths and examine any of the officers and agents thereof under oath and shall make a full and detailed report of the condition of the bank to the Comptroller of the Currency: . . . .

I. *The Right to Indemnity*

California law recognizes two forms of indemnity: contractual (either express or implied) and equitable.[2] The parties to this action are in agreement that indemnity in this action, if it arises at all, must be found on the equitable indemnity theory.

The doctrine of equitable indemnity is discussed in *People ex rel. Department of Public Works* v. *Daly City Scavenger Co.*, 19 Cal. App. 3d 277, 281, 96 Cal. Rptr. 669 (1971):

> The right to such type of indemnity depends upon an equitable consideration of the difference between primary and secondary liability: it "inures to a person who, without active fault on his part, is compelled by reason of legal obligation or relationship to pay damages which have been caused by the acts of another." [citations omitted] Such indemnification requires an indemnity claimant to prove that (1) the damages sought to be shifted were imposed as a result of a legal obligation owed to the injured party, and (2) the indemnity claimant did not actively or affirmatively participate in the wrongdoing.

A slightly different statement of these requirements is found in *Alisal Sanitary District* v. *Kennedy*, 180 Cal. App. 2d 69, 4 Cal. Rptr. 379 (1960):

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[2] The parties agree that the applicable law on the issue of indemnity is that of California. Under the Tort Claims Act, the United States is liable whenever "a private person would be liable to the claimant in accordance with the law of the place where the act or omission occurred." 28 U.S.C. § 1346(b).

> [Equitable indemnity] is a right which enures to a person who, without active fault on his part, has been compelled by reason of some legal obligation, to pay damages occasioned by the initial negligence of another, and for which he himself is only secondarily liable. The difference between primary and secondary liability is not based on a difference in *degrees* of negligence or on any doctrine of *comparative* negligence— . . . It depends on a difference in the *character* or *kind* of wrongs which cause the injury and in the nature of the legal obligation owed by each of the wrongdoers to the injured person. *Id.* at 180 Cal. App. 2d 75, quoted in B. Witkin, SUMMARY OF CALIFORNIA LAW, Torts § 22A, at 503-04 (1969 Supp. to Vols. 1, 2).

Whichever definition of the rule is accepted, it is clear that indemnity is based upon two tests: (1) the existence of a duty running to the original plaintiff, and (2) different character of the negligence of the original defendant and that of the party from whom indemnity is sought. Each of these requirements will be discussed separately.

A. *Duty Owed by the Comptroller of the Currency*

Although there has been some dispute between the parties as to the nature of the duty which must be found to give rise to a right of indemnity, the cases cited indicated that the requisite duty is that which runs from the United States or the Comptroller of the Currency to the plaintiffs (class plaintiffs or plaintiff in intervention).

The United States has argued that there is no such duty, citing *Social Security Administration Baltimore Federal Credit Union* v. *United States,* 138 F. Supp. 639 (D. Md. 1956) (*"SSA Credit Union"*). This Court would find

the reasoning of that decision to be persuasive, and would hold that there is no duty sufficient to meet the first requirement of equitable indemnity.

In the *SSA Credit Union* case, the plaintiffs alleged that examiners of the Bureau were negligent in failing to discover certain illegal acts and in the manner in which they reported those violations which they did find. The issue in that case was virtually identical to that presented by this motion: "Whether the government owed any duty to plaintiff credit union in connection with the examinations which can be made the basis of a claim under the Federal Tort Claim Act." *Id.* at 642. The court held that it did not.

> No statute imposes such a duty on the government. . . . This provision [12 U.S.C. §1756, relating to examination of credit unions] is essentially similar to the [section 481] of Title 12 U.S.C.A. dealing with the examination of National Banks. . . . The detection of fraud is not a primary function of this examination. . . . "The ordinary examination incident to the issuance of an opinion respecting financial statements is not designed and *cannot be relied* upon to disclose the defalcations and other similar irregularities. . . ." The verification of accounts is the responsibility of the officers and directors of a bank. . . . *Id.* at 645-47.

The Third-Party Plaintiff relies primarily upon several Supreme Court cases[3] to support his contention that the

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[3] Easton v. Iowa, 188 U.S. 220 (1903); Deitrick v. Standard Surety & Casualty Co., 303 U.S. 471 (1938); Deitrick v. Greaney, 309 U.S. 190 (1940).

Comptroller does have such a duty. Even if the statements in those cases were other than dicta, they would not support recognition of a duty of the nature asserted by the plaintiff.[4] It cannot be disputed that an examination which disclosed certain violations of the Banking Act could benefit shareholders, creditors, and depositors of a bank. However, neither the language of the statute nor these cases indicate that the examination contemplated by § 481 is required to be of the scope which would be necessary if it were intended to discover all such violations. This court would agree with the decisoin in the *SSA Credit Union* case that the purpose of the examination is to judge the operations of the bank, not to detect all frauds and deficiencies for the protection of creditors and shareholders. The examination is designed to supply the Comptroller and other government administrators with the information necessary to perform their regulatory functions. This court concludes that the examination is not intended to create an actionable duty to the examined banks.

Hahn argues that Supreme Court decision in *Indian Towing Co.* v. *United States,* 350 U.S. 61 (1955), indicates that although there is no statutory duty the fact that the Comptroller has undertaken these examinations creates a duty on the part of the government to conduct such examinations with due care. In *Indian Towing,* the operator of a tug boat brought suit under the Tort Claims Act, alleging that damages sustained when the boat went

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[4] Deitrick v. Standard Surety & Casualty Co., *supra* n.3, is not applicable. As the third-party defendant states, the statement that bank examiners are "representatives of the depositors and other creditors," *id.* at 480, is nothing more than a remark made in argument by the attorney for the unsuccessful appellant.

aground were caused by the negligent operation of the lighthouse by the Coast Guard. The Supreme Court reversed the lower court ruling dismissing the complaint, stating:

> The Coast Guard need not undertake the lighthouse service. But once it exercised its discretion to operate a light on Chandeleur Island and engendered reliance on the guidance afforded by the light, it was obligated to use due care to make certain that the light was kept in good working order. . . . *Id.* at 69.

The decision in this case is not contrary to that in *Indian Towing*. The crucial difference is the purpose for which such task is performed. It is clear that the reason for operating the lighthouse was to provide warning to ships. The examinations conducted under § 481, as indicated above, are designed to assist the government in the regulation of national banks, not to provide warnings of violations to such banks.

This distinction is pointed out by those cases in which the Federal Aviation Agency has been held liable for negligently certifying the safety of aircraft systems or failing to provide adequate warnings to pilots.

> Unlike the situation in the Social Security Administration case where there was no law casting upon the government any duty to make a comprehensive and active audit of Federal Credit Union accounts for the protection of credit unions, in this case we have a statutory duty imposed upon the F.A.A. to provide for safety of aircraft, and a rule having the force and effect of law prescribing the same thing. . . . *Furumizo* v. *United States,* 245 F. Supp. 981, 993 (D. Haw. 1965).

Finally, as the government states, the expanding scope of accountants' liability demonstrated by *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 174 N.E. 441 (1931) and *Rusch Factors Inc.* v. *Levin,* 284 F. Supp. 85 (D.R.I. 1968) is not relevant. The distinction is demonstrated by the California case which expanded the right to recover damages by a person not in privity with the alleged tortfeasor, *Biakanja* v. *Irving,* 49 Cal. 2d 647, 320 P.2d 16 (1958). The California Supreme Court indicated that one of the factors to be considered in deciding whether a defendant will be held liable to a third person not in privity is "the extent to which the transaction was intended to affect the plaintiff." *Id.* at 49 Cal. 2d 650. As has previously been indicated, there is no indication that the bank examinations were designed for the purpose of guaranteeing the safety of all national banks and bank shareholders, and therefore the Comptroller has no enforceable duty to these entities and persons. *See National Auto. & Cas. Ins. Co.* v. *Atkins* 45 Cal. App. 3d 562, 119 Cal. Rptr. 618 (1975); *Banville* v. *Schmidt,* 37 Cal. App. 3d 92, 112 Cal. Rptr. 126 (1974).[5]

B. *The Quality of the Negligence of the Directors and the Comptroller*

Even if it were found that the Comptroller did owe a duty to the plaintiffs in the manner in which the bank examinations were performed, this court would hold that indemnity would not be warranted in this case. As noted

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[5] *See also* Davis v. Federal Deposit Insurance Corporation, 369 F. Supp. 277 (D. Colo. 1974): "We find nothing in the statute or the case law which imposes upon the F.D.I.C. a duty to advise the general public on an insured bank's financial condition, be it good or bad. Since the F.D.I.C. was under no duty to disclose to the public its failure to do so is not actionable." *Id.* at 280.

above, indemnity should be permitted only where there is a difference between the character or kind of wrongs of the original defendant and of the party from whom indemnity is sought.

The Third-Party Plaintiff has alleged only that the Comptroller was *negligent* in the carrying out of his examination. Both the Second Amended Consolidated Complaint filed by the class plaintiffs and the complaint in intervention allege that the various defendants acted negligently, knowingly, and willfully. Clearly, if the trier of fact were to find that any of Hahn's improper actions were committed knowingly or willfully, he would not be entitled to indemnity from a merely negligent Comptroller.

However, even if the trier of fact were to conclude that Hahn's wrongful acts were only negligent, and that the Comptroller also acted negligently, indemnification would not be justified, in the opinion of this court. At best, the government's negligence is of the same character as that of the directors of the bank, i.e., a failure to detect certain violations of law and fiduciary duties.

The Supreme Court has noted that bank directors must "exercise the diligence which prudent men would usually exercise in ascertaining the condition of the business of the bank." *Bowerman* v. *Hamner,* 250 U.S. 504, 513 (1919). The management of the affairs of a national bank is expressly committed to its directors, 12 U.S.C. § 71, who are required to take an oath that they will "diligently and honestly administer the affairs of such association." 12 U.S.C. § 73. This court finds nothing in the statutes, regulations, or caselaw which would permit a director of a national bank to delegate any of his responsibilities for managing the bank to the Comptroller of the Currency or any other person or entity, or to ignore his duties in reliance upon the Comptroller's examinations. As counsel for the

government has stated, to permit such a transfer of responsibility would require the United States to act as guarantor of all national banks, and would place it in the banking business without giving it the ability to make management decisions. There is no indication that this result ever was intended, and public policy would not justify it.

II. *The Exceptions of the Tort Claims Act*

Although the disposition of the issues regarding indemnity renders unnecessary resolution of the issues relating to exceptions to the Federal Tort Claims Act, some brief remarks may be appropriate.

A. *The Discretionary Function Exception*

The provisions of the Tort Claims Act precludes liability for "[a]ny claim based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency." 28 U.S.C. § 2680(a) In discussing this exception, the courts have distinguished between decisions made at the "planning" level and those at the "operational" level. *United Air Lines, Inc.* v. *Wiener*, 335 F.2d 379, 392 (9th Cir.), *cert. dismissed*, 379 U.S. 951 (1964). This distinction means, in essence, that the government is immune from liability in determining what policy should be—e.g., in the establishment of regulations and procedures—but that once the government has adopted a particular procedure, it may be held liable for failing properly to satisfy its requirements. *Griffin* v. *United States*, 500 F.2d 1059, 1069 (3d Cir. 1974).

The Comptroller has established certain regulations regarding examination of national banks. For example, it has enacted the *Comptroller's Handbook of Examination*

Procedures. Suits for damages challenging the procedures set forth in the *Handbook* might be barred by the "discretionary functions" exception to the Tort Claims Act. However, that exception does not apply to suits alleging failure properly to execute the examination in a manner set forth in the *Handbook*. The decision in this case is not that the government need not follow its own procedures and regulations, but only that, in the context of this lawsuit, failure to do so creates no cause of action in the bank director for indemnity.

A different situation is presented by the third cause of action. This claim is based upon 12 U.S.C. § 1818(e) *et seq.* Section 1818(e)(2) states that whenever the Comptroller believes that any officer or director of a national bank has committed any violation of law or participated in any unsafe or unsound banking practice which has or may damage the bank or the financial security of the depositors, "the Comptroller of the Currency may certify the facts to the Board of Governors of the Federal Reserve System." The Board of Governors is given the power to remove such officer or director from office or to suspend him.

The duty of the Comptroller to certify facts to the Board of Directors of the Federal Reserve Bank is the type of policy decision as to which the government is immunized from liability under § 2680(a). The decision of the Comptroller as to whether or not to certify the facts and the determination by the Board as to whether to take action are analogous, in the opinion of this court, to the election by a prosecutor to prosecute a particular case. This conclusion is supported by the language of the statute which indicates that "whenever in the opinion of the Comptroller" a violation has occurred, the Comptroller "*may certify*" the facts to the Board. *Davis* v. *Federal*

Deposit Insurance Corporation, 369 F. Supp. 277, 280 (D. Colo. 1974).

The case of *Pealo* v. *Farmers Home Administration,* 361 F. Supp. 1320 (D.D.C. 1973) is not to the contrary. In th t case the use in the relevant statute of the phrase "may not" was not intended to provide the agency with discretion, but instead was interpreted to remove certain options from those otherwise available to the Secretary of Agriculture in the setting of interest rates.

Accordingly, this court would conclude that the third cause of action is barred by the "discretionary function" exception to the Tort Claims Act, but that the first and second claims raised by the third-party complaint do not fall within that provision.

B. *The Misrepresentation Exception*

Exclusion (h), 28 U.S.C. § 2680(h), bars "[a]ny claim arising out of . . . misrepresentation." If the bank directors otherwise were entitled to indemnity, this provision would not apply to this case for the reasons applicable in *United Air Lines, Inc.* v. *Wiener, supra* at 379:

> The government's reliance upon 28 U.S.C. § 2680(h) relating to exemption from the Tort Claims Act of causes of action predicated upon misrepresentation is misplaced. This section applies to claims arising out of misrepresentation. United States v. Neustadt, 366 U.S. 696 (1960). Here, the gravamen of the action is not misrepresentation but the negligent performance of operational tasks, although such negligence consisted partly of a failure of a duty to warn. *Id.* at 398.

C. *The Exception for Regulation of the Monetary System*

Section 2680(i) creates an exception for "[a]ny claim for damages caused by the fiscal operations of the Trea-

sury or regulation of the monetary system." The parties have not cited any reported cases construing this provision. The government argues, however, that the monetary system in this country essentially is the banking system, and that "money" is defined by economists with reference to the banking system since it is characterized as currency in circulation demand deposits.

The definition proposed by the government is overly broad. Monetary policy has been defined as those "activities of the federal government intended to produce changes in the money supply, the availability of loanable funds, or the level of interest rates to influence general economic activity."[6] Based upon this definition, this court would hold that although some regulation of the banking system might fall within the definition of "regulation of the monetary system," not all supervision of banking fits within this provision. The particular conduct at issue in this case—i.e., the carrying out of bank examinations requried by § 481—does not fall within the scope of the § 2680(i) exception.

III. *Conclusion*

Thus, the court is of the opinion that, although the doctrine of sovereign immunity is no bar to maintenance of the first and second causes of action in Hahn's Third-Party Complaint, these causes of action fail to state a claim upon which relief can be granted. The doctrine of equitable indemnity cannot be used by a director of a national bank to transfer his statutory liability to the United States. Accordingly

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[6] W. Haines, "Monetary Policy," in ECONOMIC ENCYCLOPEDIA 73/74, 158-59 (1973); *see also*, P. Samuelson, ECONOMICS 144 (8th ed. 1970).

IT IS ORDERED that the motion of the third-party defendant United States to dismiss the third-party complaint brought by Ernest W. Hahn is granted, and the complaint is dismissed for failure to state a claim upon which relief can be granted.

Dated: 7/28/75

/s/ William B. Enright

William B. Enright, Judge
United States District Court

APPENDIX H

EXCERPT FROM PLAINTIFFS' BRIEF FILED IN THE COURT OF APPEALS (pp. 6-7)

* * *

In reaching its holding, the district court apparently misconstrued the oral argument of plaintiff's counsel, relying in its decision on the misunderstanding that ". . . plaintiff is not arguing that tort claims against the United States can arise out of the ordinary, although negligent, performance by federal agencies of their regulatory banking functions." (App. 63) The court went on to indicate its understanding Emch was relying solely on alleged negligence in extraordinary activities of the kind referred to in *re Franklin National Bank Securities Litigation,* 445 F.Supp. 723, 728, 731, 733-34 (E.D.N.Y. 1978). Both the transcript of the oral argument (R. 12 pp. 20-33) and Emch's written brief (R. 3) make clear that the district court erred. It is true Emch did and continues to contend that, particularly in the final days before the declaration of American City Bank's insolvency, government regulators in effect took over running of the bank and in running it made many errors. But Emch has never, in any respect, waived his claims of operational-level negligence by government examiners and regulators during the years leading up to the insolvency. (See, e.g., R. 12 at p. 24)

* * *

No. 80-956

In the Supreme Court of the United States

OCTOBER TERM, 1980

HAROLD H. EMCH, JR. AND ELIZABETH R. EMCH,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether petitioners' allegation that they were damaged by negligent regulation of a bank by federal banking agencies states a claim under the Federal Tort Claims Act.

2. Whether the district court abused its discretion in denying petitioners leave to amend their complaint to include charges that were not raised before the administrative agencies.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-12) is reported at 630 F. 2d 523. The opinion of the district court (Pet. App. 13-21) is reported at 474 F. Supp. 99.

JURISDICTION

The judgment of the court of appeals (Pet. App. 22) was entered on September 12, 1980. The petition for a writ of certiorari was filed on December 11, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

On October 21, 1975, the American City Bank & Trust Company was declared insolvent by the Comptroller of the Currency and was taken over by the Federal Deposit Insurance Corporation (FDIC) acting as receiver. This insolvency rendered worthless approximately 39,480 shares of stock held by petitioners[1] in American Bankshares Corporation, a bank holding company holding 100% of the outstanding shares of the American City Bank. Petitioners filed administrative claims with the Comptroller of the Currency, the FDIC and the Federal Reserve Board (Pet. App. 1-2). The essence of those claims was that petitioners had suffered monetary damages due to the agencies' failure from 1971-1975 "to properly and adequately supervise, examine and control" the American City Bank and to "take proper and adequate measures to preserve and conserve the assets" of the bank (*id.* at 2).

Following the denial of those administrative claims, petitioners initiated this action in the United States District

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[1]The owner of the shares was Harold H. Emch, Sr., who commenced this action but has since died. Petitioners are co-representatives of Emch's estate who have continued the suit. "Petitioners" will be used to refer to the plaintiff in this lawsuit, whether the plaintiff at a particular time was Emch himself or the estate representatives.

Court for the Eastern District of Wisconsin under the Federal Tort Claims Act (FTCA), 28 U.S.C. 1346(b), 2671-2680. The complaint (Pet. App. 24-31) generally alleged that the United States, acting through the Comptroller of the Currency, the FDIC and the Federal Reserve Board, was negligent "at the operational level" in the regulation and examination of American City Bank and American Bankshares Corporation in the period preceding the bank's insolvency. The district court dismissed the complaint for failure to state a cause of action, ruling that the suit was barred by the "discretionary function" and "misrepresentation" exceptions to the FTCA, 28 U.S.C. 2680(a) and (h) (Pet. App. 16-18).[2] The court specifically rejected (*id.* at 17-18) petitioners' contention that their complaint stated claims relating to agency management of the day-to-day operations of the bank similar to those held actionable in *In re Franklin National Bank Securities Litigation*, 445 F. Supp. 723 (E.D. N.Y. 1978).[3] The district court also denied

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[2]28 U.S.C. 2680(a) and (h) make the Federal Tort Claims Act inapplicable to:

> (a) Any claim based upon an act or omission of an employee of the Government, exercising due care, in the execution of a statute or regulation, whether or not such statute or regulation be valid, or based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused.
>
> * * * * *
>
> (h) Any claim arising out of assault, battery, false imprisonment, false arrest, malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit, or interference with contract rights * * *.

[3]In that case, the court held that if a federal banking agency exceeded its normal regulatory role and assumed substantial control over the day-to-day operations of a bank, such that the bank and its directors came to rely upon the agency's decisions, the United States could be liable for the negligent performance of those duties. 445 F. Supp. at 728, 731-734. The court also held, however, that negligent performance by

a motion to amend the complaint to assert a "*Franklin National Bank*-type" cause of action on the ground that such a claim was not presented to the administrative agencies (Pet. App. 19-21). See 28 U.S.C. 2675(a).

The court of appeals affirmed (Pet. App. 1-12). The court found that the complaint could not "reasonably be interpreted as stating claims for negligence in the day-to-day operation and management of a bank or bank holding company. Rather, the essence of the claims [was] the allegation of negligent performance of regulatory and statutory supervision or monitoring of the bank entities" (Pet. App. 9-10). Therefore, the suit was barred by the "discretionary function" exception to the FTCA, 28 U.S.C. 2680(a) (Pet. App. 6-7, 10).[4] The court of appeals further held that the district court correctly denied petitioners leave to amend their complaint to encompass claims not made at the administrative level (*id.* at 11-12).

ARGUMENT

1. Petitioners contend (Pet. 5) that this case presents a "question of broad national importance" concerning the applicability of the FTCA to "operational-level negligence" in the course of federal bank regulation. Because the courts below found that no claim of negligent operation of a bank was presented by petitioners' complaint (cf. *In re Franklin National Bank Securities Litigation, supra*), however, the question here is simply whether federal banking agencies' negligent performance of their regulatory duties gives rise

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federal agencies of their normal statutory duties to supervise and examine banks did not give rise to a cause of action against the United States. 445 F. Supp. at 729-731.

[4]Indeed, the court stated that petitioners did not even contend that the negligent performance of the banking agencies' statutory duties gave rise to liability under the FTCA (Pet. App. 7).

to a cause of action under the FTCA.[5] The court of appeals correctly answered that question, and its decision does not warrant review by this Court.

This Court considered the scope of the "discretionary function" exception to the FTCA in *Dalehite* v. *United States*, 346 U.S. 15 (1953). The Court examined the legislative history of the Act and concluded that Section 2680(a) was intended to protect the government "against tort liability for errors in administration or in the exercise of discretionary functions" or, in other words, "liability arising from acts of a governmental nature." 346 U.S. at 27, 28. Contrary to petitioners' suggestion (Pet. 5), the exception is not restricted to broad planning or policy decisions, but extends to the implementation of those policies by subordinates. "Where there is room for policy judgment and decision there is discretion. It necessarily follows that acts of subordinates in carrying out the operations of government in accordance with official directions cannot be actionable." *Dalehite* v. *United States*, *supra*, 346 U.S. at 36.

Accordingly, it is well established that Section 2680(a) bars a suit under the FTCA for negligent performance of regulatory duties. See, *e.g.*, *First National Bank in Albuquerque* v. *United States*, 552 F. 2d 370, 377 (10th Cir.), cert. denied, 434 U.S. 835 (1977); *Weinstein* v. *United States*, 244 F. 2d 68, 71 (3d Cir.), cert. denied, 355 U.S. 868 (1957). Here, petitioners' claim that the banking agencies failed adequately to control the operation of the bank plainly contemplates that the agencies should have acted differently in exercising their discretion in regulating the

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[5]Petitioners themselves note (Pet. 8) that "the gravamen of [their] allegations deals precisely with the ordinary, though negligent, performance of bank examination and regulation activities by federal agents."

bank. Such a claim is barred by 28 U.S.C. 2680(a).[6] The lower courts thus have uniformly held that an individual may not sue under the FTCA based upon negligent regulation by federal banking agencies. *First State Bank of Hudson County* v. *United States*, 599 F. 2d 558 (3d Cir. 1979), cert. denied, 444 U.S. 1013 (1980); *Harmsen* v. *Smith*, 586 F. 2d 156 (9th Cir. 1978); *In re Franklin National Bank Securities Litigation, supra*; *Social Security Administration Baltimore Federal Credit Union* v. *United States*, 138 F. Supp. 639 (D. Md. 1956). See also *Redmond* v. *United States*, 518 F. 2d 811 (7th Cir. 1975) (SEC regulation).

2. There is similarly no merit to petitioners' contention (Pet. 15-16) that the district court erred in denying them leave to amend their complaint. The court found that the complaint, if so amended, would have stated a claim entirely different from that presented to the administrative agencies, and hence that an essential prerequisite to an FTCA action would have been lacking. 28 U.S.C. 2675(a).[7] The district court would then have been obligated to dismiss the complaint. See, *e.g.*, *Best Bearings Co.* v. *United States*,

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[6]Moreover, to the extent petitioners' claim is based on the government's failure to prevent the issuance of fraudulent reports or to warn them of the bank's financial difficulties, it is barred by the "misrepresentation" exception to the FTCA, 28 U.S.C. 2680(h). A failure to warn cannot be characterized as any tort other than an implied misrepresentation that no problems exist. See, *e.g.*, *Preston* v. *United States*, 596 F. 2d 232 (7th Cir.), cert. denied, 444 U.S. 915 (1979). The issuance of fraudulent bank reports is a misrepresentation by the bank; if the blame for their issuance is ascribed to the government's negligence, the claim is simply one of negligent misrepresentation, which cannot be brought under the FTCA. See *United States* v. *Neustadt*, 366 U.S. 696 (1961).

[7]28 U.S.C. 2675(a) provides in pertinent part: "An action shall not be instituted [under the Federal Tort Claims Act] * * * unless the claimant shall have first presented the claim to the appropriate Federal agency and his claim shall have been finally denied by the agency in writing * * *."

463 F. 2d 1177, 1179 (7th Cir. 1972). Thus, the district court acted properly in denying petitioners' motion to amend the complaint.[4]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 1981

DOJ-1981-02